Supreme Court, U.S.
FILED
(1)
No. 011445 MAR 26 2002
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

October Term, 2001

DONALD A. HOFFEND, SR.,

Petitioner,

vs.

JAMES ALAN VILLA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT.

PETITION FOR WRIT OF CERTIORARI

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39 pp

QUESTION PRESENTED FOR REVIEW

Whether a bankruptcy debtor's debt as a "controlling person" under 15 U.S.C. §78t(a) for the actual fraud of another person is nondischargeable under 11 U.S.C. §523(a)(2)(A) as a debt for actual fraud?

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REPORTS OF OPINIONS BELOW

The opinion of the United States Bankruptcy Court for the Southern District of Florida (Paul G. Hyman, U.S.B.J.) is unreported and is included in the Appendix at pages A 12 to A 13. The opinion of the United States District Court for the Southern District of Florida (Hon. Kenneth L. Ryskamp, U.S.D.J.) is unreported and is included in the Appendix at pages A 14 to A 17.

The opinion of the United States Court of Appeals for the Eleventh Circuit is reported at 261 F.3d 1148 (11th Cir. 2001) and is included in the Appendix at A 1 to A 11.

JURISDICTION

The petitioner Donald A. Hoffend, Sr. ("Hoffend") seeks review of a final judgment of the United States Court of Appeals for the Eleventh Circuit filed August 15, 2001. (A 1). On December 26, 2001 the United States Court of Appeals for the Eleventh Circuit filed its order denying Hoffend's request for a panel rehearing. (A 18).

This Court has jurisdiction to review the judgment by writ of certiorari pursuant to 28 U.S.C. §1254(1).

STATUTES

11 U.S.C. §523(a)(2)(A) provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by–
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

Section 20(a) of the Securities Exchange Act, 15 U.S.C. §78t(a) provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

STATEMENT OF THE CASE

Hoffend alleged the following facts in his complaint. Inasmuch as this matter arose in connection with a motion to dismiss Hoffend's complaint for failure to state a claim, these facts have been accepted as true. (A 4).

Beginning in December 1986 and continuing through 1994, Hoffend maintained an investment account with H.J. Meyers & Co., Inc. ("H.J. Meyers"). (A 2). During this time, H.J. Meyers, through its employees, gave investment advice to Hoffend.

At all relevant times, respondent James Alan Villa ("Villa") was president, sole shareholder, a director, sole controlling person and National Association of Securities Dealers, Inc. ("NASD") principal securities executive, of H.J. Meyers. (A 2). Additionally, as a result of sanctions imposed in or about 1990 by the Securities and Exchange Commission upon, among others, Villa personally and H.J. Meyers, Villa was designated, by name, as the person individually responsible for all legal and securities compliance obligations of H.J. Meyers and its officers, employees and affiliates. (Complaint ¶36).

Hoffend lost a significant amount of his investments through H.J. Meyers. (Complaint ¶42). In 1995 Hoffend commenced an arbitration proceeding through the NASD against several persons, including Villa and H.J. Meyers. (A 2).

Among Hoffend's claims against Villa was a claim for actual fraud. (A 2). In particular, although Hoffend acknowledged that Villa had made no misrepresentations personally to Hoffend, Hoffend alleged that other H.J. Meyers' officers and employees for whom Villa is legally responsible under nonbankruptcy law made fraudulent statements and omissions to Hoffend. (A 3).

On June 15, 1999, Villa filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code with the United States Bankruptcy Court for the Southern District of Florida. (A 3). This stayed completion of the arbitration.

On September 28, 1999 Hoffend filed with the Bankruptcy Court the complaint commencing this action. (A 3). By motion served October 22, 1999 Villa moved to dismiss Hoffend's complaint for failing to state a claim upon which relief could be granted. (A 3). By order dated December 20, 1999, the Bankruptcy Court granted Villa's motion and dismissed Hoffend's complaint in its entirety. (A 12).

Hoffend appealed to the United States District Court for the Southern District of Florida. By order dated June 5, 2000, the District Court affirmed the Bankruptcy Court's order. (A 14).

Hoffend appealed to the United States Court of Appeals for the Eleventh Circuit. Although disagreeing with the reasoning of the courts below, by order entered August 15, 2001, the Court of Appeals affirmed the dismissal of Hoffend's complaint. (A 1). By order entered December 26, 2001, the Court of Appeals denied Hoffend's request for a panel rehearing. (A 18).

Jurisdiction was proper in the court of first instance, the Bankruptcy Court, pursuant to 28 U.S.C. §§157(b)(2)(I) and 1334(b).

ARGUMENT

This appeal and request for review involves only one legal issue. No questions of fact are involved. For the following reasons, the Court should grant a writ of certiorari and review the order of the Court of Appeals.

1. The Eleventh Circuit's Decision Disregards the Clear Language of the Bankruptcy Code and is in Apparent Conflict with the Decision of Another Court of Appeals.

A. The Clear Language of the Statute

11 U.S.C. §523(a)(2)(A) provides in relevant part that:

> (a) A discharge....does *not* discharge an individual debtor from *any debt*....
>
> (2) for money,...., to the extent obtained by
>
> (A) false pretenses, a false representation or actual fraud,.....(emphasis added).

Section 523(a)(2)(A) does not require that the bankruptcy debtor actually perpetrate the actual fraud on the creditor. Rather, by making "any debt for money ... obtained by actual fraud ..." nondischargeable, 523(a)(2)(A)'s focus is on the *type* of debt the bankruptcy debtor owes (i.e., a debt based on actual fraud), not the conduct of the debtor. That is, if a debtor owes a debt for any reason based on actual fraud, it is nondischargeable. Indeed, as one commentator has put it "....it is the intrinsic character of the debt, not the identity of the debtor, that determines nondischargeability [for purposes of §523(a)(2)(A)]." Ponoroff, Vicarious Thrills: The Case for Application of Agency Rules in Bankruptcy Dischargeability Litigation, 70 Tulane L. Rev. 2515, 2550 (1996).

Based on the clear language of 523(a)(2)(A), court after court, with few exceptions, has denied the bankruptcy discharge to innocent persons liable under nonbankruptcy law for the actual fraud of another. *See, e.g., BancBoston Mortgage Corp. v. Ledford (In re Ledford),* 970 F.2d 1556 (6th Cir. 1992) *cert. denied sub nom. Sikes v. BancBoston Mortgage Corp.,* 507 U.S. 916 (1993) (affirming denial of discharge to innocent bankrupt partner where actual fraud of guilty partner imputable under partnership law); *Luce v. First Equipment Leasing Corp. (Matter of Luce),* 960 F.2d 1277, 1282 (5th Cir. 1992) (fraud imputed to an innocent partner "regardless of his knowledge or involvement for purposes of 11 U.S.C. §523(a)(2)(A)"); *Moore v. Gill (Matter of Gill),* 181 B.R. 666, 674 (Bankr. N.D. Ga. 1995) ("[f]or purposes of section 523(a)(2)(A), this Court does not find it necessary to make a distinction between active fraud and fraud imputed by the acts of a partner"); *Lail v. Weaver (In re Weaver),* 174 B.R. 85, 89 (Bankr. E.D. Tenn. 1994); *Giacalone v. Malget (In re Malget),* 165 B.R. 933, 936 (Bankr. S.D. Cal. 1994).

In addition to the clear language of the statute, courts applying §523(a)(2)(A) continue to rely on the Supreme Court's decision in *Strang v. Bradner,* 114 U.S. 555 (1885), decided under the Bankruptcy Act of 1867. In *Strang,* this Court determined, under a statute similar to 523(a)(2)(A)[1/], that the innocent bankrupt partners of an individual who committed actual fraud in the course of their business could not themselves be discharged of the fraud debt. The Court in *Strang* initially

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1/ §33 of the Bankruptcy Act of 1867 provided in relevant part that "No debt created by the fraud or embezzlement of the bankrupt ... shall be discharged under this Act." As noted in *Deodati v. M.M. Winkler & Associates (In re Winkler),* 239 F.3d 746, 749 (5th Cir. 2001), 523(a)(2)(A) is more strict on debtors than this provision of the Bankruptcy Act of 1867 was.

observed that for nondischargeability purposes "actual fraud" is required, not implied fraud. *Id.* at 559. The Supreme Court then stated, however, that because actual fraud was present in the case before it, "....we are of the opinion that his fraud is to be imputed, for purposes of the action, to all members of his firm." *Id.* at 561.

In its decision below, the Eleventh Circuit concluded that *Strang* and 523(a)(2)(A) were inapplicable because Villa's liability to Hoffend, if any, for actual fraud under §20(a) of the Securities Exchange Act would be imputed to him as "controlling person" and not under agency or partnership law. (A 9). The statute provides no basis for distinguishing among the theories or ways in which a debtor can owe a debt for actual fraud. The Eleventh Circuit, however, concluded that a debt based on actual fraud imputed under agency or partnership theories is nondischargeable under 523(a)(2)(A) but that a debt for actual fraud imputed to a controlling person under the securities laws is. The Eleventh Circuit impermissibly created a requirement under 523(a)(2)(A) not present in the statute itself nor reasonably inferred from the statute. *See, e.g., Kaiser Aluminum & Chemical Corp. v. Bonjorno,* 494 U.S. 827, 835, 110 S.Ct. 1570, 108 L.Ed.2d 842 (1990) (the language of a statute "'must ordinarily be regarded as conclusive'."); *HSSM #7 Limited Partnership v. Bilzerian (In re Bilzerian),* 100 F.3d 886, 891 (11th Cir. 1996) (affirming denial of a discharge under 523(a)(2)(A) where the debtor himself did not receive the money obtained by actual fraud and rejecting "plac[ing] a limitation on §523 that is not apparent from the text of the provision itself.").

B. Apparent Conflict with Fifth Circuit

In *Deodati v. M.M. Winkler & Associates (In re M.M. Winkler Associates)*, 239 F.3d 746, 749 (5th Cir. 2001) the Fifth Circuit applied §523(a)(2)(A) to prevent the discharge of an innocent partner based on the actual fraud committed by another partner and stated that:

> "....the plain meaning of the statute is that debtors cannot discharge any debts that arise from fraud *so long as they are liable to the creditor for the fraud.*" (emphasis added)

The Fifth Circuit thus made clear that if a debtor is liable to a creditor for a debt based on actual fraud *for any reason,* then pursuant to §523(a)(2)(A) that debt cannot be discharged. The Fifth Circuit did not state that the imputation of actual fraud for discharge purposes is limited to agency or partner relationships. The Eleventh Circuit, on the other hand, has now held that if a debtor's debt based on actual fraud is imputed under a securities law "controlling person" theory, and not agency or partnership law, it is dischargeable.

The Eleventh Circuit's opinion is at odds with the Fifth Circuit's opinion in another important respect. The Eleventh Circuit's decision was almost entirely based on the undue emphasis the court placed on the uncodified doctrine that exceptions to discharge are to be narrowly construed in favor of the debtor. (A 2, A 7, A 10). The Fifth Circuit in *M.M. Winkler* 239 F.3d *supra* at 751 addressed this concept and declared:

> "... it is worth noting the limits of the maxim that exceptions to dischargeability are to be construed narrowly in favor of the debtor. *This maxim cannot overcome the plain language Congress used to define exceptions from dischargeability.*" (emphasis added)

Despite these differences between the Fifth Circuit's analysis of 523(a)(2)(A) and the Eleventh Circuit's, the Eleventh Circuit cursorily treated the Fifth Circuit's opinion, along with several other opinions, only in a footnote and addressed none of these significant distinctions. (fn. 8, A 9-10). Rather, the Eleventh Circuit merely declared *M.M. Winkler* to be inapplicable because it dealt with a partnership situation.

Inasmuch as the Fifth Circuit in *M.M. Winkler* did not address the exact question faced by the Eleventh Circuit, the decisions are not in direct conflict. However, it is clear that the Eleventh Circuit and the Fifth Circuit are in apparent conflict as to the scope of 523(a)(2)(A). The Fifth Circuit unequivocally declared, in a case involving imputed fraud, that *any debt* based on actual fraud is nondischargeable; the Eleventh Circuit declared, in a case involving imputed fraud, that fraud imputed under agency or partnership law is nondischargeable but fraud imputed under §20(a) of the Securities Exchange Act is. This conflict, combined with the Eleventh Circuit's disregard of the text of the statute, warrants review by the Court. *Commissioner v. Asphalt Products Co., Inc.,* 482 U.S. 117, 120, 107 S.Ct. 2275, 96 L.Ed.2d 97 (1987) (granting certiorari because holding in apparent conflict with the holding of another Court of Appeals and holding in obvious conflict with the plain language of the statute).

That all of this poses a significant legal question to be resolved by this Court is borne out by the Eighth Circuit's recent decision in *Owens v. Miller (In re Miller),* 276 F.3d 424 (8th Cir. 2002) (Beam dissenting) and especially its dissent. In *In re Miller,* the Eighth Circuit confronted the same issue as was before the Eleventh Circuit: whether actual fraud may be imputed to a bankrupt "controlling person" for purposes of 523(a)(2)(A). The Eighth Circuit reversed the decisions of the bankruptcy court (*In re Miller,* 240 B.R. 566 (Bankr. W.D. Mo.

1999)) and the district court (No. 99-1198 (W.D. Mo. September 24, 2000)) and concluded that such a debt is dischargeable. The two-judge majority of the Eighth Circuit followed the Eleventh Circuit's reasoning and ignored the language of 523(a)(2)(A). Judge Beam in dissent, though, observed that the Supreme Court's decision in *Strang* allowed a finding of nondischargeability and that in fact the language of 523(a)(2)(A) required nondischargeability. *In re Miller,* 276 F.3d *supra* at 431 (8th Cir. 2002).

2. The Eleventh Circuit's Decision Conflicts with a Relevant Decision of this Court.

In *Cohen v. de la Cruz,* 523 U.S. 213, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998), this Court held that the punitive damages portion of a debt for fraud is nondischargeable under 523(a)(2)(A). In so holding, this Court rejected the argument that for nondischargeability purposes a distinction should be made between the compensatory and punitive portions of a debt for actual fraud. The Court reasoned that under 523(a)(2)(A):

> "[o]nce it is established that specific money or property has been obtained by fraud, however, *'any debt' arising therefrom is excepted from discharge."* (emphasis added).

Cohen, 523 U.S. *supra* at 218. Clearly, this Court has directed that the proper analysis under 523(a)(2)(A) is whether the debtor owes a debt based on actual fraud, not the theory of underlying liability. The Eleventh Circuit has ignored this Court's instruction. Instead, the Eleventh Circuit has concluded that, at least when imputed actual fraud is involved, the underlying theory of recovery (i.e., actual fraud imputed based on agency or partnership versus actual fraud imputed based on other law) is determinative.

In refusing to distinguish between the punitive and compensatory portions of a debt for actual fraud for purposes of 523(a)(2)(A), this Court stated that if Congress had intended such result "... one would expect Congress to have made unmistakably clear its intent to distinguish among theories of recovery in this manner." *Cohen,* 523 U.S. *supra* at 221. By distinguishing among theories of recovery for purposes of applying 523(a)(2)(A), the Eleventh Circuit's decision conflicts with the relevant decision of this Court in *Cohen.*

3. The Question Presented is of National Significance And Should be Addressed Now.

The question that would be presented to the Court if a writ of certiorari is granted is of national significance. The issue combines important questions of securities law and bankruptcy law. Moreover, in light of the many recent bankruptcies, including Enron and Global Crossing, involving serious allegations of fraud, a decision on the issue raised here would be of great interest to corporate officers, principals and their counsel.

Further, this issue does not need any further treatment in the lower courts. As already shown, many courts have considered the issue of the dischargeability of a debt based on imputed actual fraud. While most courts have made it clear that a debt for actual fraud imputed under nonbankruptcy law is nondischargeable, there still is disarray that should be cleared up by this Court.

For example, creating a minority position apparently of one, the court in *Walker v. Citizens State Bank of Maryville, Missouri (Matter of Walker),* 726 F.2d 452, 454 (8th Cir. 1984) indicated that the fraud of an agent may be imputed to a debtor-principal under 523(a)(2)(A), but only when the debtor knew or

should have known of the fraud. On remand, the bankruptcy court in *Matter of Walker,* 53 B.R. 174 (Bankr. W.D. Mo. 1985) discussed and demonstrated the errors of the Eighth Circuit's reasoning.

A few other courts have required the debtor to have personally committed the actual fraud for 523(a)(2)(A) to apply. *See, e.g., McDonald v. Buck (In re Buck),* 75 B.R. 417 (Bankr. N.D. Cal. 1987).

The disarray on the general applicability of 523(a)(2)(A) is also shown in the decisions of the Bankruptcy Court, the District Court and the Eleventh Circuit in the instant matter. In a cursory decision, the Bankruptcy Court dismissed Hoffend's complaint because Villa himself did not make any false representations. (A 13). Likewise completely ignoring the statute, the District Court affirmed the Bankruptcy Court because Villa himself did not make the false representations to Hoffend. (A 17). In reasoning that 523(a)(2)(A) applies only to debtors who perpetrate the actual fraud, the Bankruptcy Court and District Court discussed none of the relevant caselaw.

Indeed, the Eleventh Circuit determined that the authority relied upon by the Bankruptcy Court and the District Court is inapplicable. (A 4-5). The Eleventh Circuit itself, however, in failing to apply 523(a)(2)(A) as written, misread *Strang* and other decisions. For example, the Eleventh Circuit suggested that *Recoveredge L.P. v. Pentecost,* 44 F.3d 1284 (5th Cir. 1995) stands for the proposition that fraud liabilities in the corporate setting are not imputed to corporate principals for purposes of 523(a)(2)(A). (A 9). *Recoveredge* does not stand for this proposition. Rather the referenced portions of *Recoveredge* merely point out that ordinarily under *nonbankruptcy* law the fraud of an employee is not imputed to a corporate principal and that if a corporate principal is not liable in the first instance for a debt for actual fraud, then

523(a)(2)(A) is inapplicable. The corporate principal in *Recoveredge* had been found not liable under *nonbankruptcy* law for a debt based on fraud. *Recoveredge,* 44 F.3d *supra* at 1288. The issue before the court in *Recoveredge* concerned whether a breach of contract debt (as opposed to one for actual fraud) can be excepted from discharge under 523(a)(2)(A). *Id.* at 1286. Because the debtor in *Recoveredge* owed no debt based on actual fraud (the debtor's debt being one for breach of contract) the court correctly dismissed the nondischargeability complaint.

Here, if Hoffend can establish Villa's liability to him for a debt based on actual fraud under §20(a) of the Securities Exchange Act, then 523(a)(2)(A) by its plain language should preclude Villa from discharging that debt.

Hoffend respectfully requests this Court to grant his petition for a writ of certiorari.

DATED: March 25, 2002

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APPENDIX A

Decision and Order of the United States Court of Appeals for the Eleventh Circuit, Dated August 15, 2001.

[1] IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

FILED
U.S. COURT OF APPEALS
ELEVENTH CIRCUIT
AUGUST 15, 2001
THOMAS K. KAHN
CLERK

No. 00-13293

D.C. Docket No. 00-08178 CV-KLR

IN RE: James Alan Villa,

Debtor,

DONALD A. HOFFEND, SR.,

Plaintiff-Appellant,

vs.

JAMES ALAN VILLA,

Defendant-Appellee.

Appeal from the United States District Court
for the Southern District of Florida

(August 15, 2001)

Before ANDERSON, Chief Judge, FAY and BRIGHT*, Circuit Judges.

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*Honorable Myron H. Bright, U.S. Circuit Judge for the Eighth Circuit, sitting by designation.

[2] ANDERSON, Chief Judge:

This appeal arises from the Bankruptcy Court's dismissal of Plaintiff-Appellant Donald Hoffend's complaint, in which Hoffend sought to have a claim arising from alleged securities law violations deemed nondischargeable under the Bankruptcy Code's fraud exception to discharge, 11 U.S.C. § 523(a)(2)(A). In granting the Debtor James Villa's motion to dismiss, the Bankruptcy Court held that, because Hoffend did not allege that Villa committed actual fraud, Hoffend failed to state a claim of nondischargeability under § 523(a)(2)(A). The District Court affirmed. Hoffend appeals and argues that the alleged fraud of Villa's employees may be imputed to Villa under § 20(a) of the Securities Exchange Act, so as to render Hoffend's claim nondischargeable by Villa. Mindful of our obligation to construe strictly exceptions to discharge, we hold that liability under § 20(a) is insufficient to impute culpability to a debtor so as to render the liability nondischargeable under § 523(a)(2)(A). The dismissal is affirmed.

BACKGROUND

Plaintiff-Appellant Donald Hoffend maintained an investment account, from 1986 to 1994, with H.J. Meyers & Co., Inc., a brokerage firm. Defendant-Appellee James Villa was the president, sole shareholder, and principal securities executive of a corporation, H.J. Meyers. Villa did not handle Hoffend's account; instead, it was [3] managed, and allegedly fraudulently mismanaged, by two brokers who were H.J. Meyers employees. Hoffend filed an arbitration claim in 1995 with the National Association of Securities Dealers, against Villa, H.J. Meyers, and the two brokers who handled Hoffend's investment account. In the claim, Hoffend alleged, *inter alia*, violations of § 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934.

Villa filed Chapter 11 bankruptcy in June 1999.[1] In September 1999, Hoffend filed an adversary complaint in the bankruptcy proceeding, contending that his claim against Villa was nondischargeable under the Bankruptcy Code's fraud exception to discharge, 11 U.S.C. § 523(a)(2)(A).[2] Hoffend did not allege that Villa made any fraudulent reresentations to Hoffend; instead, Hoffend alleged that Villa was a controlling person under § 20(a) of the Securities Exchange Act, 15 U.S.C. § 78t(a),[3] and thus that the alleged fraud of the two H.J. Meyers brokers could be [4] imputed to Villa, so as to render Hoffend's claim nondischargeable as to Villa. Based on Hoffend's failure to allege that Villa made any false representations, Villa filed a motion to dismiss for failure to state a claim. The Bankruptcy Court granted the motion to dismiss, holding that Hoffend's allegations were insufficient to establish fraud which would preclude Villa's discharge of the claim in bankruptcy. The District Court affirmed, and Hoffend has appealed.

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1 Villa's filing of a bankruptcy petition automatically stayed Hoffend's arbitration proceeding against Villa, pursuant to 11 U.S.C. § 362(a).

2 This exception provides that any debt for money obtained by "false pretenses, a false representation, or actual fraud" is not dischargeable in bankruptcy. 11 U.S.C. § 523(a)(2)(A).

3 Section 20(a) of the Securities Exchange Act provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts consituting the violation or cause of action.

15 U.S.C. § 78t(a).

STANDARD OF REVIEW

Our review of a dismissal for failure to state a claim is *de novo*. *See In re Johannessen*, 76 F.3d 347, 349 (11th Cir. 1996) (citing *Hunnings v. Texaco, Inc.*, 29 F.3d 1480, 1484 (11th Cir. 1994)). In conducting our review we must, like the Bankruptcy Court, accept the allegations of the complaint as true and construe the alleged facts in the light most favorable the plaintiff. *See Hunnings*, 29 F.3d at 1484.

DISCUSSION

Hoffend concedes – he has never argued otherwise – that Villa made no false representation to him at any time. Based on Hoffend's failure to allege a misrepresentation by Villa, the Bankruptcy Court dismissed Hoffend's complaint for failure to allege the elements of fraud required under § 523 (a)(2)(A). In reaching this decision, the Bankruptcy Court relied on the four elements set forth in *Schwieg* [5] *v. Hunter (In re Hunter)*, 780 F.2d 1577 (11th Cir. 1986): (1) the debtor made a false representation with the purpose and intention of deceiving the creditor; (2) the creditor relied on the representation; (3) the creditor's reliance was reasonably founded; and (4) the creditor sustained a loss as a result of the representation. *Id.* At 1579. In the instant case, it is undisputed that Villa made no false representation to Hoffend; it is undisputed that Villa committed no fraud which would render Hoffend's claim nondischargeable under § 523(a)(2)(A).

Our analysis does not end, however, with the foregoing conclusion. Hoffend argues that, while Villa committed no fraud, the alleged fraud of the H.J. Meyers employees, for which Villa may be liable as a controlling person under § 20(a) of the Securities Exchange Act, should be imputed to Villa so as to render Hoffend's claim nondischargeable as to Villa. Villa relies upon *In re Hunter*. The issue there was whether a debtor's failure to volunteer information about his financial condition to a prospective lender could render the debt

nondischargeable in bankruptcy after the debtor defaulted on the loan. *See id.* at 1578-79. Relying in part on the Supreme Court's decision in *Neal v. Clark*, 95 U.S. 704 (1877), this Court held that, for a debt to fall within the exception to dischargeability, the debtor must have committed positive, actual fraud. *See In re Hunter*, 780 F.2d at 1579 (Citing *Neal*, 95 U.S. at 709). We concluded that the debtor's failure to disclose unsolicited [6] details regarding his financial condition did not satisfy the positive fraud requirement of § 523(a)(2)(A). *See id.* at 1580. While *In re Hunter* addressed the conduct that constitutes fraud under § 523(a)(2)(A), it did not address the circumstances under which fraud, once established, may be imputed to a debtor to preclude a discharge in bankruptcy; thus, the holding of *In re Hunter* is not dispositive of this case.

Hoffend relies upon *Strang v. Bradner*, 114 U.S. 555, 5 S. Ct. 1038 (1885). There, the Supreme Court addressed the issue of whether two bankruptcy debtors, who were vicariously liable under agency law for a debt incurred through the fraud of their co-partner, were precluded from discharging that debt in bankruptcy. *See id.* at 561, 5 S. Ct at 1041. *Strang* distinguished the holding of *Neal*, where the Court had interpreted fraud to mean actual or positive fraud rather than implied fraud. *See Strang*, 114 U.S. at 559, 5 S. Ct. at 1040 (citing *Neal*, 95 U.S. at 709). *Strang* held that *Neal's* positive fraud requirement was satisfied by the fraud of the debtor's co-partner. The question before the Court in *Strang* was whether the debtors, who had been unaware of their co-partner's fraud, could nonetheless be precluded from discharging the debt in bankruptcy. *See Strang*, 114 U.S. at 559, 561, 5 S. Ct. at 1040-41. The Court held that the co-partner's fraud, imputed to the debtors, precluded their discharge of the debt. *See id.* at 561, 5 S. Ct. 1041. [7] Hoffend argues that the holding of *Strang* should extend to preclude Villa's discharge of a claim based on his employees' fraud, for which Villa may be responsible under § 20(a).

Thus, under *Neal* and *Strang* and their progeny, a debt may be excepted from discharge when the debtor personally commits actual, positive fraud, and also when such actual fraud is imputed to the debtor under agency principles. Different inquiries arise under each of these ways to render a debt nondischargeable. Under the first inquiry, the issue is whether the debtor's conduct amounted to actual fraud under § 523(a)(2)(A). *See Neal*, 95 U.S. at 709 (stating that the Bankruptcy Code's fraud exception to discharge requires proof of actual fraud rather than constructive or implied fraud "which may exist without the imputation of bad faith or immorality"). Under the second inquiry, which arises when actual fraud has been committed by someone other than the debtor, the issue is whether the debtor may be held liable for the other's fraud so as to render the resulting debt nondischargeable by the debtor. *See Strang*, 114 U.S. at 561, 5 S. Ct. at 1041 (stating that, after the Court had determined that the debtor's co-partner committed actual fraud, the other question to be determined was whether the actual fraud should be imputed to the partners who were without knowledge of the fraud so as to render their debt nondischargeable also).

[8] The instant appeal focuses on the second inquiry. Hoffend argues that the holding of *Strang*, imputing actual fraud to an innocent partner under the doctrine of respondeat superior so as to render the innocent partner's debt nondischargeable, should be extended to the instant situation in which Hoffend has alleged that Villa is liable for the actual fraud of the broker-employees of H.J. Meyers, not under agency principles, but as a controlling person under § 20(a).[4] We are

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4 In the Rule 12(b)(6) posture of this case, we assume, *arguendo*, for purposes of this appeal only, first that the broker-employees committed actual fraud which would render their own liability therefor nondischargeable, and second that Villa would be liable as a controlling person under § 20(a) for the fraud of his broker-employees.

not convinced that the reach of *Strang* extends so far as to render Villa's § 20(a) liability nondischargeable under § 523(a)(2)(A).

In reaching this conclusion, we are mindful of our obligation to construe strictly exceptions to discharge in order to give effect to the fresh start policy of Bankruptcy Code. *See In re Walker*, 48 F.3d 1161, 1164-65 (11th Cir. 1995). Thus, we are bound to a narrow reading of *Strang*. *Strang* imputed liability for fraud in bankruptcy based on the common law of partnership and agency. *See Strang*, 114 U.S. at 561, 5 S. Ct. at 1041. In the instant case, there is no suggestion that Villa and the H.J. Meyers broker-employees were partners, so partnership law, as applied to *Strang*, is inapplicable in this case. While it may be argued that the [9] holding of *Strang* was founded on general principals of agency law, rather than limited to the particular confines of partnership law, liability under § 20(a) is not equivalent to liability under the common law of agency. *See Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980) (holding that common law agency principles, including the doctrine of respondeat superior, are distinct from § 20(a), and that both § 20(a) and respondeat superior are distinct theories which may be relied upon in imposing secondary liability for violations of the Securities Exchange Act).[5] Significantly for our purposes, § 20(a) liability

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5 The Eleventh Circuit, in the *en banc* decision *Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir. 1981), adopted as precedent decisions of the former Fifth Circuit rendered prior to October 1, 1981. The majority of our sister circuits, as well, have held that common law agency principles remain as separate basis, distinct from § 20(a), for imposing secondary liability for § 10(b) violations. *See Commerford v. Olson*, 794 F.2d 1319, 1323 (8th Cir. 1996); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1577-78 (9th Cir. 1990), *cert. denied*, 499 U.S. 976, 111 S. Ct. 1621, 113 L.Ed.2d 719 (1991); *In re Atlantic Fin. Management, Inc.*, 784 F.2d 29, 35 (1st Cir. 1986); *Henrickson v. Henrickson*, 640 F.2d 880, 887 (7th Cir.), *cert denied*, 454 U.S. 1097, 102 S. Ct. 669, 70 L.Ed.2d 637 (1981); *Marbury Mgt., Inc. v. Kohn*, 629 F.2d 705, 716 (2d cir.), *cert denied*, 449 U.S. 1011, 101 S. Ct.

may, in some instances, be imposed where agency liability under *Strang* would not. Under this Court's interpretation of the term "controlling person" under § 20(a), a "controlling person" may include not only partners or principles under agency law, but also a person who has the power to control the conduct of another person who [10] has violated securities laws. *See Brown v. Enstar Group, Inc.*, 84 F.3d 393, 396 (11th Cir. 1996) (holding that a defendant is liable as a controlling person if he had the power to control the general affairs of the entity primarily liable at the time the entity violated the securities laws, and had the requisite power to directly or indirectly control or influence the specific corporate policy which resulted in the primary liability), *aff'g Brown v. Mendel*, 864 F. Supp. 1138 (M.D. Ala. 1994), *cert. denied*, 519 U.S. 1112, 117 S. Ct. 950, 136 L.Ed.2d 838 (1997). *See also Cheney v. Cyberguard Corp.*, 2000 WL 1140306, at *6 (S.D. Fla. Jul 31, 2000) (holding that shareholder-plaintiffs stated a § 20(a) claim against a corporation's Chairman of the Board, President, and CEO, based on his power to control the corporate policy that resulted in corporate liability under § 10(b)). Thus, corporate officers and directors, persons who are presumptively beyond the reach of respondeat superior,[6] may be caught in the net of §

566, 66 L.Ed.2d 469 (1980); *Holloway v. Howerdd*, 536 F.2d 690, 696 (6th Cir. 1976); *Carras v. Burns*, 516 F.2d 251, 259 (4th Cir. 1975); *Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731, 741 (10th Cir. 1974). The Third Circuit has held that respondeat superior remains available, apart from § 20(a), in certain securities cases. *See Sharp v. Coopers & Lybrand*, 649 F.2d 175, 181 (3d Cir. 1981) (accounting firm defendant); *Rochez Bros. V. Rhoades*, 527 F.2d 880, 884-86 (3d Cir. 1975) (broker-dealer defendant).

6 Under the doctrine of respondeat superior, corporate employer is responsible for the conduct of its employees. *See Florida Real Estate Commission v. McGregor*, 336 So.2d 1156, 1159 (Fla. 1976). Absent exceptional circumstances, however, this liability does not extend to corporate principles or shareholders. *See Dania Jai-Alai Palace, Inc. v. Sykes*, 450 So.2d 1114, 1120-21 (Fla. 1984) (holding that liability for an employee's negligence extends only to the employer-corporation, based on

20(a).[7] In this light, to hold that § 20(a) liability may [11] render a debt nondischargeable under § 523(a)(2)(A) would be to extend the holding of *Strang* beyond its basis in agency law. We conclude that the potential scope of § 20(a) liability does not fall within a narrow reading of *Strang*. We decline to expand the holding of *Strang*; thus, we hold that a debtor's § 20(a) liability for another's fraud – to the extent that it expands the imputation of liability beyond respondeat superior liability – does not impute culpability to the debtor so as to render a debt nondischargeable by the debtor under § 523(a)(2)(A).

Although it may be true that § 20(a) liability is akin to agency liability in some respects, fraud liabilities, other than securities violations, resulting from the actions of a corporate employee are not ordinarily imputed to the principals or shareholders of the corporation and rendered nondischargeable under § 523(a)(2)(A). *See RecoverEdge L.P. v. Pentecost*, 44 F.3d 1284, 1296-97 (5th Cir. 1995) (rejecting the argument that the fraud of one corporate officer, director, and shareholder should be imputed to another officer, director, and shareholder, the President, noting that the involved officer was not an agent of the President of the corporation). We see nothing in the bankruptcy laws,[8] the securities laws, or the [12] legislative

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the rule that persons using the corporate form to conduct business are protected from personal liability unless the corporation is formed or used for an illegal, fraudulent or other unjust purpose which justifies piercing of the corporate veil)(citation ommitted).

7 *Accord Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1117-18 (5th Cir. 1980) (observing that, in enacting § 20(a), "Congress intended to extend the coverage of the [federal securities] acts to encompass persons who exercised effective control over persons [11] directly liable for violations of the acts and upon whom agency law or other common law principles would not impose liability").

8 Hoffend argues that a line of cases following *Strang* supports his position that another's fraud may be imputed to a debtor to render a debt nondischargeable by the debtor. *See, e.g., In re M.M. Winkler & Assocs.*,

history of § 20(a) to suggest that such a liability resulting from violations of securities laws should be treated differently for purposes of the fraud exception from dischargeability. To the contrary, well established bankruptcy law directs courts to construe narrowly exceptions to discharge in order to give affect to the fresh start policy of the Bankruptcy Code. Congress has enacted numerous very specific exceptions to discharge, *see* 11 U.S.C. § 523; we believe that an exception for § 20(a) liability should come from Congress and not the judiciary.

Hoffend did not allege, and does not argue, that Villa is liable pursuant to respondeat superior for the alleged fraud of the H.J. Meyers employees.[9] There being no issue of liability pursuant to respondeat superior in this appeal, we hold that Villa's potential § 20(a) liability is not in itself sufficient to render the debt nondishcargeable under § 523(a)(2)(A).

[13] Hoffend cites *Owen v. Miller*, 240 B.R. 566 (Bankr. W.D. Mo. 1999), as particular support for his argument that fraud may be imputed under § 20(a) for nondischargeability

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239 F.3d 746, 751 (5th Cir. 2001) (holding that a debt incurred [12] through the fraud of one business partner was nondischargeable as to innocent partners who, although unaware of the fraud, were liable for the debt under state partnership law); *BancBoston Mortgage Corp. v. Ledford*, 970 F.2d 1556, 1561 (6th Cir. 1992) (holding that an obligation based on partner's fraud was nondischargeable by a debtor although the debtor neither knew of nor ratified his partner's fraud), *cert. denied sub nom., Sikes v. BancBoston Mortgage Corp.*, 507 U.S. 916, 113 S. Ct. 1272 (1993); *Luce v. First Equip. Leasing Corp.*, 960 F.2d 1277, 1282 (5th Cir. 1992) (holding that a husband's fraudulent acts in his capacity as his wife's business partner were imputed to the wife, making the debt nondishcargeable by her under § 523(a)(2)(A)). These cases are not helpful to Hoffend, as they rely on principles of agency law to impute liability, and they were decided in the context of the business partnership framework. As discussed above, § 20(a) liability does not fall within the narrow scope of this precedent.

9 Thus, we address no issues relating to a claim of liability on the part of Villa pursuant to respondeat superior.

purposes. Like the instant case, the plaintiffs in *Owens* sought to impute to the Chairman of the Board and President-Chief Executive Officer liability for the actual fraud of a broker-employee of the corporate brokerage firm. The bankruptcy court noted the general rule that an employee of a corporation is not an agent of the corporation's principles, thus acknowledging that there was no respondeat superior liability. *See id.* at 578. However, the court held that there was § 20(a) controlling person liability. *See id.* at 580. Although recognizing that no reported case had ever found nondischargeability on the basis of § 20(a) imputed liability, the court indicated that § 20(a) created an agency-like relationship, and held that the § 20(a) imputed liability of the corporate principals was nondichargeable under § 523(a)(2)(A). *See id.* at 580-81.

We are not persuaded by *Owens*. As noted above, we believe that the relationship described by § 20(a) is distinct from an agency relationship, and we decline to expand the holding of *Strang* beyond liabilities imposed pursuant to the doctrine of respondeat superior.

[14] CONCLUSION

For the foregoing reasons, the District Court's order affirming the Bankruptcy Court's dismissal of Hoffend's nondischargeability complaint is AFFIRMED.

APPENDIX B

Order of the United States Bankruptcy Court, Southern District of Florida, Granting James Alan Villa's Motion to Dismiss, Dated December 20, 1999.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA

IN RE: CASE NO. : 99-32913-BKC-PGH
CHAPTER 11

James Alan Villa,
Debtor.
_____/

Donald A. Hoffend, Sr.,

Plaintiff,

ADV. NO. :99-3221-BKC-PGH-A

v.

James Alan Villa,

Defendant.
_____/

ORDER GRANTING JAMES ALAN VILLA'S MOTION TO DISMISS

THIS MATTER came before the Court on October 22, 1999, upon James Alan Villa's ("Defendant") Motion to Dismiss. On September 28, 1999, Donald A. Hoffend, Sr. ("Plaintiff") filed the above-captioned adversary complaint (the "Adversary Complaint") to determine the dischargeability of a debt under §523 (a)(2)(A) as a debt for money obtained by actual fraud, false pretenses and/or false representations. Plaintiff admits that he had no direct contact with the Defendant and that Plaintiff's only contact with Defendant was through Defendant's employees and subordinates.

In *Schweig v. Hunter (In re Hunter)*, 780 F.2d 1577 (11th Cir. 1986), the Eleventh Circuit stated that in order for a debt to be nondischargeable under §523 (a)(2)(A), a creditor must prove four elements:

a. that the debtor made a false representation with the purpose and intention of deceiving the creditor;

b. that the creditor relied on such representation;

[2] 3. that the creditor's reliance was reasonably founded; and

4. that the creditor sustained a loss as a result of the misrepresentation.

Id. at 1579. The court further stated that "[t]he debtor must be guilty of positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or morality." *Id.* Relying on *Davison-Paxon Co. v. Caldwell*, 115 F.2d 189 (5th Cir. 1941), *cert. denied* 313 U.S. 564 (1941), the court in *Hunter* found that there must be an "actual overt false pretense or representation to come within the exception" to discharge. *Id.* at 1580

Therefore, with the Court having considered the Motion to Dismiss, arguments of counsel at the Hearing, and relevant and applicable authority, and being otherwise fully advised in the premises, it is hereby ORDERED AND ADJUDGED that:

Defendant's Motion to Dismiss is GRANTED because the adversary complaint fails to allege any misrepresentation made by Defendant to Plaintiff.

DONE AND ORDERED in Fort Lauderdale, Florida, this 20th day of December, 1999.

s/ Paul G. Hyman, Jr.
PAUL G. HYMAN, JR.
United States Bankruptcy Judge

APPENDIX C

Order of the United States District Court, Southern District of Florida, Affirming the Bankruptcy Court's Order, Dated June 5, 2000.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
WEST PALM BEACH

Case No. 00-8178-CIV-RYSKAMP

REC'D by ____ D.C.

JUN 06 2000

CLARENCE MADDOX
CLERK U.S. DIST. CT.
S.D. OF FLA. W.P.B.

FILED by Illegible D.C.

JUN 5 2000
CARLOS JUENKE
CLERK U.S. DIST. CT.
S.D. OF FLA. W.P.B.

CLOSED CASE

IN RE:

JAMES ALAN VILLA,

Debtor

_____/

DONALD A. HOFFEND, SR.,

Plaintiff/Appellant,

vs.

JAMES ALAN VILLA,

Defendant/Appellee.

_____/

ORDER AFFIRMING THE BANKRUPTCY COURT'S ORDER

THIS CAUSE came before the Court upon the Appellant's, Donald A. Hoffend, Sr., appeal of final order of the United States Bankruptcy Court granting the Appellee's, James Alan Villa, motion to dismiss [**DE 1**], filed on February 29, 2000.

I. BACKGROUND

On February 22, 2000, Judge Paul G. Hyman, Jr., U.S. Bankruptcy Judge, issued an Order granting the appellee's motion to dismiss. The basis for Judge Hyman's decision was that the appellant had failed to allege that the appellee made an actual or overt false misrepresentation to the appellant. Relying primarily on *Schweig v. Hunter*, 780 F.2d 1577 (11th Cir. 1986), the Bankruptcy Court concluded that the appellant did not meet its burden of pleading that the debt [2] was nondischargeable under 11 U.S.C. §523(a)(2)(A). Thereafter, the creditor, Donald A. Hoffend, Sr., appealed the Bankruptcy Order to this Court. The appellant claims that false representations made by employees under the appellee's control should have been imputed to the appellant. The Court disagrees with the appellant for the reasons stated herein.

II. LEGAL STANDARD

The United States District Courts have *de novo* review over conclusions of law and the legal significance accorded the bankruptcy court's findings of fact. *In re Calvert*, 907 F.2d 1069, 1071 (11th Cir. 1990); *Bakst v. Marks*, 131 B.R. 220 (S.D. Fla. 1991), *aff'd*, 976 F.2d 743 (11th Cir. 1992); *In re Owens*, 86 B.R. 691 (M.D. Fla.1988), *aff'd* 877 F.2d 44 (11th Cir. 1989). Where the bankruptcy court has made findings of law, the district court is nowise bound by the decision and must independently determine the accuracy of the legal conclusions adopted by the bankruptcy judge on the basis of the facts shown. *In re Cricker*, 46 B.R. 229 (N.D. Ind. 1985).

Conversely, findings of fact are not to be set aside unless clearly erroneous pursuant to Fed. R.Banks.P. 8013. A finding is "clearly erroneous" when after reviewing the entire record, the appellate court is left with definite and firm conviction that a mistake has been made. *In re Calvert*, 907 F.2d 1069, 1071 (11th Cir. 1990); *In re Prestwood*, 185 B.R. 358 (M.D. Ala. 1995). Reasonable interpretations of evidence different from that reached by the bankruptcy court are clearly not enough to overturn a bankruptcy court's factual findings. *Szewczyk v. Wojtaszek*, 164 B.R. 604 (N.D. Ill. 1994). A similar standard applies to the bankruptcy court's equitable determinations, which are reviewed under an abuse of discretion standard. *In re Red Carpet Corp. of Panama City Beach*, 902 F.2d 883 (11th Cir. 1990).

III. DISCUSSION

[3] The issue on appeal is whether the Bankruptcy Court correctly concluded that the appellant must plead that there was positive fraud or fraud in fact for a debt to be nondischargeable under 11 U.S.C. §523(a)(2)(A). In reaching its conclusion, the Bankruptcy Court relied upon the four elements in *Schwieg v. Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986)[1]: "1) the debtor made a false representation with the purpose and intention of deceiving the creditor; 2) the creditor relied on such representations; 3) his reliance was reasonably founded; and 4) the creditor sustained a loss as a result of the representation." *Id.* at 1579. The Eleventh Circuit in *Schweig v. Hunter* further stated that "[t]he Debtor must be guilty of positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, and not implied fraud, or fraud in law, which may exist without

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1 The Court notes that the sufficiency of evidence standard was reversed by the Supreme Court in *Grogan v. Garner, Jr.*, 498 U.S. 279, 284-86, 111 S. Ct. 654, 658-59 (1991). However, the holding in *Grogan* does not effect the elements laid out in *Schweig v. Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986) or the fact that the debtor must be guilty of positive fraud in order to preclude discharging a debt on the basis of fraud.

the imputation of bad faith or immorality." *Id.*

In this case, the Bankruptcy Court properly found that the appellant had failed to state a cause of action because the appellant did not allege that the appellee made a false representation to the appellant. Thus, the Bankruptcy Court granted the appellee's motion to dismiss, concluding that the appellant did not allege that the appellee was guilty of a positive fraud as required by *Schwieg v. Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986). In fact, the appellant admits that the appellee did not make personal misrepresentations to the appellant. (Appellant's Br., at 4; Compl. ¶¶15-30.)

IV. CONCLUSION

[4] Accordingly, the Court has considered the appeal and the pertinent portions of the record, and being fully advised in the premises it is

ORDERED AND ADJUDGED that the Bankruptcy Court's Order, on February 22, 2000, granting the appellee's motion to dismiss is hereby **AFFIRMED**.

DONE AND ORDERED in Chambers at West Palm Beach, Florida, this 5 day of ~~May~~ June, 2000.

s/ Kenneth L. Ryskamp
KENNETH L. RYSKAMP
UNITED STATES DISTRICT JUDGE

copies provided:
The Honorable Paul G. Hyman, Jr.
Joseph W. Allen, Esq.
Andrew Tramont, Esq.

APPENDIX D

Order of the United States Court of Appeals for the Eleventh Circuit Denying Petition for Rehearing, Filed December 26, 2001.

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 00-13293 BB

FILED
U.S. COURT OF APPEALS
ELEVENTH CIRCUIT
DEC 26 2001
THOMAS K. KAHN
CLERK

DONALD A. HOFFEND, SR.,
Plaintiff-Appellant,

vs.

JAMES ALLEN VILLA,
Defendant-Appellee.

On Appeal from the United States District Court for the Southern District of Florida

BEFORE: ANDERSON, Chief Judge, FAY and BRIGHT*, Circuit Judges.

PER CURIAM:

The petition(s) for rehearing filed by appellant, DONALD A. HOFFEND, Sr., is DENIED.

ENTERED FOR THE COURT:

ILLEGIBLE
CHIEF JUDGE

*Honorable Myron H. Bright, U.S. Circuit Judge of the Eighth Circuit, sitting by designation.